



PUBLIC NOTICE

Federal Communications Commission
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**FURTHER COMMENT REQUESTED ON THE APPROPRIATE TREATMENT OF
SHARING AND LOW-END ADJUSTMENTS MADE BY PRICE CAP LOCAL
EXCHANGE CARRIERS IN FILING 1993 AND 1994 INTERSTATE ACCESS TARIFFS**

PLEADING CYCLE ESTABLISHED

1993 Annual Access Tariffs, CC Docket No. 93-193
1994 Annual Access Tariffs, CC Docket No. 94-65

Comments Due: May 5, 2003

Replies Due: May 19, 2003

This Public Notice seeks comment on the appropriate treatment of sharing and low-end adjustments made by price cap local exchange carriers (LECs) in 1992 and 1993 for purposes of calculating their rates of return in filing their interstate access tariffs for the years 1993 and 1994.

On June 23, 1993, the Common Carrier Bureau (the Bureau) suspended the 1993 annual access tariffs of price cap LECs that had implemented sharing or low-end adjustments in 1992. The Bureau imposed an accounting order and designated for investigation the issue of the appropriate treatment of sharing and low-end adjustments made by price cap LECs in 1992 in calculating their 1992 rates of return and their consequent sharing obligations or low-end adjustments for 1993.¹ The investigation of this issue had not been completed when price cap LECs filed their 1994 access tariffs. Therefore, the Bureau suspended the 1994 annual access tariffs of price cap LECs that had implemented a sharing or low-end adjustment in 1993. The Bureau incorporated the issue of the appropriate treatment of sharing and low-end adjustments made by price cap LECs in 1993 in calculating their 1993 rates of return and consequent sharing

¹ See *1993 Annual Access Tariff Filings*, CC Docket No. 93-193, *National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates*, Transmittal No. 556, CC Docket No. 93-123, *GSF Order Compliance Filings*, *Bell Operating Companies Tariff for the 800 Service Management System and 800 Data Base Access Tariffs*, CC Docket No. 93-129, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, 8 FCC Rcd 4960, 4965, para. 32 (Com. Car. Bur. 1993) (*1993 Designation Order*). In March 2002, the Commission renamed the Bureau the Wireline Competition Bureau.

obligations and low-end adjustments for 1994 into the investigation of the same issue for the 1993 access tariffs.² These issues remain pending before the Commission.

I. BACKGROUND

In September 1990, the Commission replaced rate-of-return regulation for the largest LECs, including the regional Bell Operating Companies (BOCs) and GTE, with the incentive-based system of price cap regulation.³ Under rate-of-return regulation, LECs could charge rates that earned a maximum allowable return on interstate investment.⁴ If the LEC actually earned more than the maximum allowable rate of return during a specified period, the Commission required the LEC to return the excess earnings to its interstate access customers by charging lower rates in the subsequent tariff filing period.⁵ The Commission also required the LEC to treat any return of excess earnings as an adjustment to earnings in the period in which the over-earnings occurred, known as the enforcement period, rather than to the period in which the refund was actually paid by a reduction in rates, or the subsequent enforcement period.⁶ The Commission thus required the LEC to “add back” the amount of the refund for prior over-earnings into the total earnings used to compute the rate of return for the enforcement period and any consequent refund obligation for the subsequent enforcement period. The refund thus had the same effect on earnings that it would have had if the LEC had written a check for the amount of the over-earnings on the last day of the enforcement period during which the over-earnings occurred.⁷

Under price cap regulation, the ceiling or maximum price a LEC may charge for

² See *1994 Annual Access Tariff Filings*, CC Docket No. 94-65, *National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates*, Transmittal No. 612, Memorandum Opinion and Order Suspending Rates, 9 FCC Rcd 3705, 3713, para. 12 (Com. Car. Bur. 1994) (*1994 Designation Order*).

³ *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990) (*LEC Price Cap Order*). At that time there were seven regional BOCs. As a result of mergers and acquisitions, today there are four. For a complete summary of the original price cap plan, see *LEC Price Cap Order*, 5 FCC Rcd at 6787-89, paras. 5-19.

⁴ The maximum allowable rate of return consists of the prescribed rate of return plus four tenths of one percent of the prescribed rate of return. See 47 C.F.R. § 67.700.

⁵ The Commission’s former rule requiring direct refund of excess earnings to customers was found to be arbitrary and capricious without a corresponding method for carriers to recover underearnings. *AT&T Co. v. FCC*, 836 F.2d 1386, 1389, 1393 (D.C. Cir. 1988).

⁶ *Amendment of Part 65, Interstate Rate of Return Prescription: Procedures and Methodologies to Establish Reporting Requirements*, CC Docket No. 86-127, Report and Order, 1 FCC Rcd 952, 956-57, para. 43 and Appendix C (1986) (establishing a rate of return monitoring report, which includes a line to record the amount of the refund). See also *Price Cap Regulation of Local Exchange Carriers, Rate of Return Sharing and Lower Formula Adjustment*, CC Docket No. 93-179, Notice of Proposed Rulemaking, 8 FCC Rcd 4415 (1993) (*Add Back Notice*); *Price Cap Regulation of Local Exchange Carriers, Rate of Return Sharing and Lower Formula Adjustment*, CC Docket No. 93-179, Report and Order, 10 FCC Rcd 5656 (1995) (*Add Back Order*).

⁷ *Add Back Order*, 10 FCC Rcd at 5656-57, para. 2.

interstate access services is adjusted annually by a price cap index that is a measure of inflation minus a productivity factor, or "X-Factor."⁸ Price cap regulation is intended to encourage growth in productivity by permitting price cap LECs that increase their productivity to earn higher profits, while at the same time ensuring that interstate access customers share in the benefits of productivity growth in the form of lower rates.⁹ Under the original price cap plan, a LEC's interstate rate of return in one year could be the basis for "back stop" adjustments to that carrier's price cap indices and rates in the following year.¹⁰ Specifically, the Commission required price cap LECs opting for an X-factor of 3.3 percent and earning a rate of return above 12.25 percent to "share" half of earnings above that level with their interstate access customers by lowering their rates in the following year.¹¹ The Commission's rules also permitted price cap LECs earning less than 10.25 percent in a particular year to adjust their rates upward in the following year to achieve an earnings rate of at least 10.25 percent for the year in which they under-earned.¹² This mechanism is called a "low-end" or "lower formula" adjustment. The Commission adopted these rate-of-return based "back stop" adjustments to ensure that LEC rates under price cap regulation did not become unreasonably high or low due to the varying operational and economic circumstances of the many individual LECs.¹³ The Commission determined that the sharing and low-end adjustments would be one-time adjustments to a single year's rates, so as not to affect future earnings.¹⁴ To provide price cap LECs greater incentives to increase efficiency, the Commission eliminated the sharing obligation in 1997.¹⁵

The Bureau permitted NYNEX and the Southern New England Telephone Company (SNET)¹⁶ to make low-end adjustments in 1992 to compensate for under-earnings they

⁸*Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, Fourth Report and Order, *Access Charge Reform*, CC Docket No. 96-262, Second Report and Order, 12 FCC Rcd 16642, 16646, para. 3 (1997) (*Price Cap Fourth Report and Order*). See also *LEC Price Cap Order*, 5 FCC Rcd at 6792, paras. 47-49. Exogenous costs also are added in determining the price cap index. See 47 C.F.R. § 61.45(a).

⁹ *LEC Price Cap Order*, 5 FCC Rcd at 6790-91, paras. 21-37.

¹⁰ *Id.* at 6801, paras. 120-21.

¹¹ *Id.* at 6801, para. 124. A price cap LEC opting for an X-factor of 3.3. percent and earning a rate of return above 16.25 percent was required to share all earnings above that level with its access customers. *Id.* at 6801, para. 125.

¹² *Id.* at 6802, para. 127. This low end adjustment has been eliminated for price cap LECs that exercise pricing flexibility. 47 C.F.R. § 69.731.

¹³ *Id.* at 6801, para. 120. See also *Add Back Notice*, 8 FCC Rcd at 4416, para. 7.

¹⁴ *Id.* at 6803, para. 136. See also *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Order on Reconsideration, 6 FCC Rcd 2637, 2691 n.166 (1991) (*LEC Price Cap Reconsideration Order*), *aff'd sub nom. National Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993).

¹⁵ See *Price Cap Fourth Report and Order*, 12 FCC Rcd at 16699-70, paras. 147-48.

¹⁶ NYNEX has now merged with Bell Atlantic and GTE to become Verizon. SNET has become one of the SBC companies.

experienced in 1991. Thereafter, in filing their 1993 interstate access tariffs, NYNEX and SNET restated their 1992 earnings, excluding the revenues they received in 1992 due to the higher rates they were allowed to charge as a result of the low-end adjustment. This restatement reduced the 1992 earnings and rates of return of both NYNEX and SNET and their consequent 1993 sharing obligations. According to AT&T, which protested this restatement when NYNEX and SNET filed their 1993 access tariffs, NYNEX's restatement of 1992 earnings reduced its 1993 sharing obligation by \$19.7 million.¹⁷ SNET's restatement of 1992 earnings allegedly eliminated the sharing obligation it otherwise would have had in 1993.¹⁸ Because this issue was relevant to all price cap LECs' sharing and low-end adjustment calculations, the Bureau suspended the potentially-affected 1993 access tariffs for one day, imposed an accounting order, and designated this issue for investigation.¹⁹

Before the Bureau completed this investigation, price cap LECs filed their 1994 interstate access tariffs. The Bureau permitted NYNEX and SNET to make low-end adjustments again in 1993 to compensate for under-earnings they experienced in 1992, and NYNEX and SNET again excluded the revenues resulting from these adjustments from their 1993 earnings in calculating their 1994 sharing obligations. AT&T again protested this restatement of 1993 earnings, claiming that it reduced NYNEX's 1994 sharing obligation by \$15.9 million and eliminated SNET's 1994 sharing obligation.²⁰ Because of the similarities of the "add back" issues in 1993 and 1994, the Bureau suspended the 1994 access tariffs of the price cap LECs that had implemented a sharing or low-end adjustment in 1993 and incorporated the 1994 access tariffs into the 1993 investigation.²¹ In doing so the Bureau stated: "After the termination of the 1993 investigation and prior to the termination of this [1994] investigation, we will give parties an opportunity to present any legal argument or factual circumstances that would lead us to conclude that the decisions reached in [the 1993 investigation] on add-back issues should not control our treatment of the 1994 access transmittals."²²

Simultaneously with the Bureau's suspension of the 1993 access tariffs of the price cap LECs that had implemented a sharing or low-end adjustment in 1992, the Commission adopted a Notice of Proposed Rulemaking (NPRM) to consider further the appropriate treatment of these adjustments. The NPRM tentatively concluded that the add back adjustment should continue to be part of the rate-of-return calculations of LECs subject to price caps, requiring them to "add back" or remove the effect of any sharing obligation or low-end adjustment in a particular year to determine their rates of return for that year and their consequent sharing obligation or low-end adjustment in the following year.²³ The Commission ultimately adopted this tentative conclusion,

¹⁷ *1993 Annual Access Tariffs*, Petition of American Telephone and Telegraph Company at 22 (filed Apr. 27, 1993).

¹⁸ *Id.* at 23-24.

¹⁹ *1993 Designation Order*, 8 FCC Rcd at 4965, para. 32.

²⁰ *1994 Annual Access Tariffs*, Petition of AT&T Corp. at 9-11 (filed Apr. 26, 1994).

²¹ *1994 Designation Order*, 9 FCC Rcd at 3713, para. 12.

²² *Id.*

²³ *Add Back Notice*, 8 FCC Rcd at 4417, para. 15.

reasoning that, as with over earning rate-of-return carriers subject to refund requirements, price cap LECs implementing a sharing or low-end adjustment in one year should be required to “add back” or remove the effect of those adjustments in calculating rates of return for that year, and consequent sharing or low-end adjustments in the subsequent year.²⁴ In applying its rate-of-return reasoning to price cap carriers, the Commission explained:

Suppose a LEC earned \$400 million from its interstate operations in 1994, with \$100 million of that amount subject to a 50 percent sharing obligation. Pursuant to our rules, the LEC would be required to flow back \$50 million to its ratepayers in 1995. If the LEC replicates its 1994 performance in 1995 by earning \$350 million (i.e., \$400 million minus the \$50 million sharing adjustment), should it be allowed to say that it must only share half of the \$50 million to consumers in 1995 due to its 1994 performance? It is clear that under our reporting rules for carriers subject to rate-of-return regulation the answer is ‘no’; in this order, we conclude that the answer is also ‘no’ prospectively for companies subject to price cap regulation.²⁵

II. CURRENT PROCEEDING

While the Commission resolved other issues designated for investigation regarding the 1993 and 1994 interstate access tariffs, and resolved the add back issue for subsequent tariffs, the add back issue for the 1993 and 1994 tariffs is still outstanding.²⁶ The purpose of this Public Notice is to seek comment on the appropriate treatment of sharing and low-end adjustments in the 1993 and 1994 access tariffs, to refresh a record that, due to passage of time and several mergers and acquisitions among the interested parties, may have now grown stale. A specific issue on which we seek comment is similar to an issue designated for investigation in 1993: How should price cap LECs have reflected amounts from prior year sharing or low-end adjustments in computing their rates of return for that prior year and their consequent sharing and low-end adjustments to price cap indices for the following year? Appropriate amounts of the sharing or low-end adjustments should be specified. In addition, we ask for comment on an issue raised by commenters in the 1993 and 1994 access tariff investigations: Would application of the add back rule to the 1993 and 1994 access tariffs constitute unlawful retroactive application of a substantive rule change?²⁷ Finally, as stated in our *1994 Designation Order*, parties may present any legal argument or factual circumstance that would lead us to conclude that the decision reached with respect to appropriate treatment of sharing and low-end adjustments for the 1993 access tariffs should not control our treatment of sharing and low-end adjustments for the 1994

²⁴ *Add Back Order*, 10 FCC Rcd at 5657, para. 4

²⁵ *Id.* at para. 3. The Commission explicitly declined to decide at that time whether any add back adjustment should be required for the 1993 and 1994 annual access tariffs subject to investigation. *Id.* at n.3. The District of Columbia Circuit Court of Appeals has affirmed the add back rule. *Bell Atlantic v. FCC*, 79 F.3d 1195, 1205-08 (D.C. Cir. 1996).

²⁶ See Letter from Patrick H. Merrick, Director, AT&T Federal Government Affairs, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 93-193 (filed Oct. 23, 2002).

²⁷ *1994 Designation Order*, 9 FCC Rcd at 3713, para. 12.

access tariffs.

We note that, since the original tariff investigation in 1993, several of the parties have merged and that the existing record may not accurately reflect the parties' current positions on the add back issue and its application to the 1993 and 1994 access tariffs. Therefore, we ask that parties restate their positions on the issues and not merely incorporate by reference filings they may have made in the original investigation or add back rulemaking.

III. FILING PROCEDURES

Comments in response to this Public Notice are due **May 5, 2003**. Reply Comments are due **May 19, 2003**. When filing comments, please reference CC Docket Nos. 93-193 and 94-65. An original and four copies of all comments should be addressed to Marlene H. Dortch, Secretary, Federal Communications Commission, 445 12th Street, SW, Room TW-B204, Washington, DC 20554. A courtesy copy should be addressed to Chief, Pricing Policy Division, Wireline Competition Bureau, 445 12th Street, S.W., Room 5-A225, Washington, D.C. 20554, and e-mailed to jsaulnie@fcc.gov. A courtesy copy should also be addressed to Qualex International, Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, telephone (202) 863-2893, facsimile 202-863-2898, or sent via e-mail to qualexint@aol.com. Parties also are strongly encouraged to submit their comments via the Internet through the Electronic Comment Filing System at [<http://www.fcc.gov/e-file/ecfs.html>](http://www.fcc.gov/e-file/ecfs.html). Generally, only one copy of an electronic submission must be filed. In completing the transmittal screen, commenters should include their full name, Postal Service mailing address, and the applicable docket numbers, which in this instance are CC Docket Nos. 93-193 and 94-65. Parties may also submit an electronic comment via Internet e-mail. To get filing instructions for e-mail comments, commenters should send an e-mail to [<ecfs@fcc.gov>](mailto:ecfs@fcc.gov), and should include the following words in the body of the message: "get form <your e-mail address>." A sample form and directions will be sent in reply.

Interested parties who wish to file comments via hand-delivery are also notified that the Commission will only receive such deliveries weekdays from 8:00 a.m. to 7:00 p.m., via its contractor, Vistronix, Inc., located at 236 Massachusetts Avenue, NE, Suite 110, Washington, DC 20002. **The Commission no longer accepts these filings at 9300 East Hampton Drive, Capitol Heights, MD 20743.** Please note that all hand deliveries must be held together with rubber bands or fasteners, and envelopes must be disposed of before entering the building. In addition, this is a reminder that the Commission no longer accepts hand-delivered or messenger-delivered filings at its headquarters at 445 12th Street, SW, Washington, DC 20554. Messenger-delivered documents (*e.g.*, FedEx), including documents sent by overnight mail (other than United States Postal Service (USPS) Express and Priority Mail), must be addressed to 9300 East Hampton Drive, Capitol Heights, MD 20743. This location is open weekdays from 8:00 a.m. to 5:30 p.m. USPS First-Class, Express, and Priority Mail should be addressed to the Commission's headquarters at 445 12th Street, SW, Washington, DC 20554. The following chart summarizes this information:

TYPE OF DELIVERY	PROPER DELIVERY ADDRESS
Hand-delivered paper filings	236 Massachusetts Avenue, NE, Suite 110, Washington, DC 20002

	(Weekdays - 8:00 a.m. to 7:00 p.m.)
Messenger-delivered documents (<i>e.g.</i> , FedEx), including documents sent by overnight mail (this type excludes USPS Express and Priority Mail)	9300 East Hampton Drive, Capitol Heights, MD 20743 (Weekdays - 8:00 a.m. to 5:30 p.m.)
USPS First-Class, Express, and Priority Mail	445 12 th Street, SW Washington, DC 20554

***Ex Parte* Requirements**

This Public Notice is designated a permit-but-disclose proceeding and is subject to the requirements of section 1.1206(b) of the Commission's rules, 47 C.F.R. § 1.1206(b), as revised. Persons making oral *ex parte* presentations are reminded that memoranda summarizing the presentations must contain a summary of the substance of the presentation and not merely a listing of the subjects discussed. More than a one- or two-sentence description of the views and arguments presented is generally required.²⁸ Other rules pertaining to oral and written presentations are also set forth in section 1.1206(b).

Interested parties should address any memoranda summarizing oral *ex parte* presentations or written *ex parte* presentations in this proceeding to Marlene H. Dortch, Secretary, Federal Communications Commission, 445 12th Street, S.W., TW-B204, Washington, D.C. 20554. Parties making either oral or written *ex parte* presentations also should address copies of memoranda summarizing any oral *ex parte* presentations or any written *ex parte* presentations to the Chief, Pricing Policy Division, Wireline Competition Bureau, 445 12th Street, S.W., Room 5-A222, Washington, D.C. 20554 and e-mail copies to jsaulnie@fcc.gov. A courtesy copy also should be addressed to Qualex International, Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, telephone (202) 863-2893., facsimile (202)-863-2898, or sent via e-mail to qualexint@aol.com. Parties also are strongly encouraged to file copies of memoranda summarizing oral *ex parte* presentations or any written *ex parte* presentations via the Internet through the Electronic Comment Filing System at <<http://www.fcc.gov/e-file/ecfs.html>>.

For further information regarding this proceeding contact Julie Saulnier, Pricing Policy Division, Wireline Competition Bureau, (202) 418-1530.

²⁸ See 47 C.F.R. §1.1206(b)(2), as revised.